Audit's® MARKET ANALYSIS OF REITS AND REAL ESTATE COMPANIES

Realty Stock Review

March 9, 1990 (Priced Mar. 9) Volume XXI, Number 5

Stat Spotlight: Cash Flow Slows a Bit for Equity REITs

The market, says legendary investor Warren Buffett of Berkshire Hathaway, is a voting machine in the short run, but a weighing machine in the long run.

That truism stands out as we size up the 1989 earnings and cash flow results from the major equity REITs and try to project what's ahead for 1990.

Look at the voting machine in action: Prices of the fastest growing equity REITs have stalled and even declined, and the stock market has dealt harshly with stocks whose cash flow and dividends have been cut or which have not lived up to expectations.

But look at the weighing machine effect: During the bear markets of the 1960s and 1970s, a goodly number of solid REITs, mainly equity owners of multi-tenant properties, sustained cash flow and dividends and stayed out of trouble. The market paid scant attention, and their prices declined notwithstanding. But when recessions and bear markets ended — and they always do — these stocks were the market leaders on the way back up. (Mortgage REITs have less tendency to bounce back quickly since they are often leveraged highly enough that bad loans can cause long-term trouble.)

Looking at early results for 1989 encourages us to believe we are near that point in time when the voting machine effect phases out — simply because there are fewer and fewer sellers — and the weighing machine effect takes over.

Results announced to date make clear that most — but not all — major seasoned equity REITs continued upward momentum in earnings, cash flow and dividends during 1989.

The 1989 results show that while cash flow is clearly under pressure, there do not appear to be any cash flow disasters (as reflected in dividend omissions) in the group. To be sure some equity REITs have cut their dividends and their stock prices have sunk sharply in reaction. And several have kept supporting dividends from property sales while operations catch up in this enervating real estate bear market.

The key short-run question for investors is whether 1989 and expected 1990 results will be good enough. For while sustained cash flow and dividend momentum is heartening during one of the longest-running real estate recessions in years, the stock market might have been expecting even stronger showings. It's much akin to a heavyweight champion being booed for knocking out an opponent only in the *fifth* round when everyone expected a first-round kayo. The voting machine, again.

To keep longer-term cash flow and dividends squarely in your eyes, we've tallied below the cash flow numbers for 15 major equity REITs which have reported results so far. For perspective, we've included 1987 actual results and our early estimate for 1990.

Our tally is based upon a revised definition of cash flow, which is effective with this issue. We will now be basing statistics on a number we designate as "operating gross cash flow" and which most REITs are reporting as "funds from operations." To compute it, we add back depreciation and other non-cash charges to reported net operating income, on the assumption that non-cash depreciation charges for commercial property owners generally do not correlate with any value changes in underlying real estate assets. The gross cash flow results for these 15 major equity REITs start on page 2.

This table highlights the wide range of cash flows for the major equity REITs, from the plus 11.7% showing of **Federal Realty Investment Trust** to the negative 20.5% showing by **MGI Properties** (see RSR, Feb. 23). At the top of the list, three equity REITs posted double-digit operating cash flow gains and it's worthwhile to take a brief look at each:

Federal Realty Trust (FRT:NYSE) rose 11.7% on a relatively strong showing across the board of its 9.2 mil. sq. ft. of shopping centers in the Mid-Atlantic states. FRT is slowly overcoming situations which

continued on page 2

IN THIS ISSUE

Stat Spotlight: Cash Flow Growth Slows a Bit for Equity REITs 1

Statistical Tables
I - REIT Gross Cash 1987-1990 2
II - Yearly Dividend Growth 1987-90 3
III - REIT Dividend Coverage 1987-90 ..3

STOCK COMMENTS

BRE Properties 2
Burnham Pacific Properties 2
Chicago Dock & Canal Trust 4
Del-Val Financial 4
Dial REIT (table) ..... 2&3
Federal Realty Investment ..... 1&2
First Union Real Estate 3
General Homes Corp. 4
HRE Properties ..... 2&3
Hollywood Park Realty 4
IRT Property Co. (table) ..... 2&3
International Income Properties 4
Interstate General L.P. 4
MGI Properties 1
Mortgage Investments Plus 4
New Plan Realty ..... 2&3
Property Trust of America 4
Pennsylvania REIT (table) ..... 2&3
REIT of California (table) ..... 2&3
Storage Equities 4
United Dominion Realty (table) ..... 2&3
Washington REIT ..... 2&3
Weingarten Realty 2
Western Investment RE ..... 2&3

NOW AVAILABLE: Our revised brochure describing Audit's money management services.
Our companion service **REALTY STOCK DIGEST** contains complete EPS, dividend and news reports on 250 realty stocks.
Subscribers may call toll free 1-800-441-8414 or write for a free sample copy.

TABLE I -- REIT GROSS CASH FLOWS 1987-1990

REIT	Year Ended	CF per share 1987	CF per share 1988	CF per share 1989	89/'88 % Chng.	CFS E1990	90/'89 % Chng.
BRE Props.	July '89	$2.27	$2.32	$2.54	9.5%	$2.60	2.4%
Burnham Pacific	Dec. '89	1.17a	1.25	1.36	8.8%	1.40	2.9%
Dial REIT	Dec. '89	1.70	1.71	1.72	0.6%	1.75	1.7%
Federal Rlty.	Dec. '89	1.20	1.28	1.43	11.7%	1.58	10.5%
First Union RE	Dec. '89	1.45	1.42	1.44	1.4%	1.45	0.7%
HRE Props.	Oct. '89	1.77	1.45	1.34	(7.6%)	1.40	4.5%
IRT Property	Dec. '89	0.96	1.07b	1.06	(0.9%)	1.10	3.8%
MGI Props.	Nov. '89	1.59	1.61	1.28	(20.5%)	1.32	3.1%
New Plan Rlty.	July '89	0.83	0.89	0.98	10.1%	1.08	10.2%
Penn. REIT	Aug. '89	1.40	1.67	1.69	1.2%	1.75	3.6%
REIT of Calif.	Dec. '89	1.31	1.35	1.38	2.2%	1.40	1.5%
United Dominion	Dec. '89	1.19	1.29	1.33	3.1%	1.38	3.8%
Wash. REIT	Dec. '89	0.94	1.04	1.16	11.5%	1.25	7.8%
Weingarten Rlty.	Dec. '89	2.17	2.21c	2.11c	(4.5%)	2.15	1.9%
Western Inv. RE	Dec. '89	1.27	1.36	1.47	8.1%	1.58	7.5%
	TOTAL	$21.22	$21.92	$22.29	1.7%	$23.19	4.0%

a-Burnham: Nine months annualized due to fiscal year change.
b-IRT Prop. incl. $0.04 additional interest on mortgage prepayment in 1988; CFS up 2.9% before such item.
c-Weingarten incl. special items of $0.21 in 1988 and $0.05 in 1989; "normalized" CFS $2.00 and $2.06/sh.

continued from page 1

dragged down 1989 results: three new tenants have replaced failed anchors at 446,000 sq. ft. Northeast Plaza in Atlanta (one replacement tenant hasn't occupied yet); and 570,000 sq. ft. Willow Lawn enclosed mall in Richmond, Va., where four prospects are interested in taking over a 70,000 sq. ft. spot once occupied by bankrupt Miller & Rhodes. Wall Street fears about the impact of these tenant problems helped drive FRT shares below $20 briefly. With these problems receding in importance, we think there's strong possibility FRT will boost the dividend to near a $1.50 annual rate sometime in the summer or fall. Shares are a strong buy now.

Washington REIT (WRE:ASE) posted a 11.5% cash flow increase helped by stronger leasing at some key properties. Rents rose 7.6% for the year but property expenses rose only 5.4%, resulting in an 8.8% jump in net operating income from properties. Interest on $30 mil. raised via a 1.65 mil. share offering in May 1989 added 10¢ a share. Known as a canny property buyer, WRE should pick up a bit of income as it invests these funds in properties. WRE boosted payout in Nov. to the current $1.08 rate and we wouldn't expect any change until fall at the earliest. Shares remain in Portfolio Planner.

New Plan Realty (NPR:NYSE) boosted cash flow 10.1% in its July 1989 fiscal year and results to date indicate NPR will post another gain of about 10% in 1990. NPR buys older, cheaper shopping centers in New England and Midlantic states where it can earn a spread of about 4.0% over its 6.2% dividend yield, which we equate to its cost of capital. This is one of the widest spreads among equity REITs. NPR just boosted its payout to $1.06 annual rate. NPR remains in Portfolio Planner as a long-term core holding.

Three other equity REITs follow very closely behind: **BRE Properties** (BRE:NYSE), up 9.5%; **Burnham Pacific Properties** (BPP:NYSE), up 8.8%; and **Western Investment Real Estate** (WIR:ASE), up 8.1%. All own properties in the hot California realty markets, with BPP focused in the San Diego markets, BRE in northern California plus Washington state; and WIR in northern California and Nevada retail markets. California markets in all property types have shown some evidence of softening recently, with prospective military cutbacks looming large in some local markets and for specific properties. How any "peace dividend" plays out in the state may have a lot to do with how well present markets are sustained. BPP and WIR remain as core holdings in Portfolio Planner, while we continue BRE as a holding in the less timely group because of its slower dividend growth record. Among this trio, BRE is being buffeted the most by property problems: a 50,000 sq. ft. tenant at 498,000 sq. ft. Hub shopping center in Fremeont, Cal. has filed for Ch. XI bankruptcy protection but says it wants to stay in occupancy. A vacant 167,000 sq. warehouse in Pomona is being released.

These handsome gains are counterbalanced by the 20.5% decline by MGI and the 7.6% fall at HRE Properties. The decline shown for **Weingarten Realty Investors**, the Houston based shopping center owner which was a standout market performer in 1989, is skewed by inclusion of several special items in our tally, above. The 1989 results include 5¢ per share in a one-time franchise tax refund, whereas 1988 benefitted by 21¢/sh. from a lease cancellation fee and gain on sale of interest rate swap contracts. Without these special items, WRI's $2.06 per share operating CFS for 1989 would have been up 3.0%. We expect WRI CFS to move up to about $2.15 per share in 1990.

Cash flow at our 15 equity REITs rose only 1.7% for 1989 before capital gains and similar events, vs. a 3.3% gain in 1988.

Realty Stock Review SUBSCRIPTION $288 ANNUALLY, PUBLISHED TWICE MONTHLY ON THE SECOND AND FOURTH FRIDAYS. GROUP RATES ON REQUEST.
AUDIT INVESTMENTS, INC., 136 SUMMIT AVENUE, MONTVALE, NJ 07645-1720 Phone (201) 358-2735
KENNETH D. CAMPBELL, PRESIDENT / FAYE KREISMAN, STATISTICS / MICHAEL HOUSTON, ANALYST

REALTY STOCK REVIEW is published by Audit Investments Inc., an independent advisor registered with the Securities and Exchange Commission under the Investment Adviser's Act of 1940. Under no circumstances is anything contained herein to be construed as an offer to purchase or a solicitation to sell any security mentioned. Information has been obtained from sources believed to be reliable and reasonable care has been exercised in compilation, but accuracy or completeness cannot be guaranteed. Expressions of opinion are solely the responsibility of the publisher and may be changed at any time without notice. Periodical advisory services are mailed to reach subscribers no later than the Monday following publication date. Audit's officers, employees and printers are not permitted to trade upon any recommendation until the Tuesday following. Investment management clients of Audit may be effecting transactions in the securities at any time. Audit will not assign subscriptions without your consent and unused portion refunded upon request. Copyright 1990 by Audit Investments, Inc. May not be reproduced or photographed in any form without written permission.

TABLE I I -- YEARLY DIVIDEND GROWTH 1987-1990

REIT	Year Ended	--- Dividends paid in year--- 1987	1988	1989	89/'88 % Chng.	Div. E1990	90/'89 % Chng.
BRE Props.	July '89	$2.40	$2.40	$2.40	0.0%	$2.40	0.0%
Burnham Pacific	Dec. '89	1.15	1.29	1.36	5.4%	1.36	0.0%
Dial REIT	Dec. '89	1.22	1.64	1.68	2.4%	1.70	1.2%
Federal Rlty.	Dec. '89	1.11	1.23	1.38	12.2%	1.48	6.9%
First Union RE	Dec. '89	1.50	1.50	1.50	0.0%	1.50	0.0%
HRE Props.	Oct. '89	1.92	1.80	1.80	0.0%	1.80	0.0%
IRT Property	Dec. '89	1.04	1.10	1.16	5.1%	1.16	0.0%
MGI Props.	Nov. '89	1.60	1.60	1.36	(15.0%)	1.12	0.0%
New Plan Rlty.	July '89	0.81	0.89	0.97	9.0%	1.05	8.3%
Penn. REIT	Aug. '89	1.49	1.58	1.66	5.1%	1.70	2.4%
REIT of Calif.	Dec .'89	1.335	1.35	1.38	2.2%	1.38	0.0%
United Dominion	Dec. '89	1.02	1.12	1.22	8.9%	1.26	3.3%
Wash. REIT	Dec. '89	0.87	0.95	1.02	7.4%	1.08	5.9%
Weingarten Rlty.	Dec. '89	1.60	1.68	1.76	4.8%	1.88	6.8%
Western Inv. RE	Dec. '89	1.17	1.27	1.36	7.0%	1.42	4.8%
	TOTAL	$20.23	$21.40	$22.01	2.8%	$22.29	2.4%

TABLE III -- REIT DIVIDEND COVERAGE 1987-1990

REIT	Year Ended	--------Dividend/CFS Ratio------- 1987	1988	1989	E1990	Comment
BRE Props.	July '89	*1.06*	*1.03*	0.94	0.92	Improving
Burnham Pacific	Dec. '89	0.98	*1.03*	*1.00*	0.97	Tight but OK
Dial REIT	Dec. '89	0.72	0.96	0.98	0.97	Tight & flat
Federal Rlty.	Dec. '89	0.93	0.96	0.97	0.93	Room for boost
First Union RE	Dec. '89	*1.03*	*1.06*	*1.04*	*1.03*	Supporting w/ gains
HRE Props.	Oct. '89	*1.08*	*1.24*	*1.34*	*1.29*	Supporting w/ gains
IRT Property	Dec. '89	*1.08*	*1.03*	*1.09*	*1.05*	Tight, needs growth
MGI Props.	Nov. '89	*1.01*	0.99	*1.06*	*1.03*	Turnaround
New Plan Rlty.	July '89	0.98	*1.00*	0.99	0.97	Room for boost
Penn. REIT	Aug. '89	*1.06*	0.95	0.98	0.97	Room for boost
REIT of Calif.	Dec. '89	*1.02*	*1.00*	*1.00*	0.99	Boosted 2.9% on 3/13
United Dominion	Dec. '89	0.86	0.87	0.90	0.89	Some room for growth
Wash. REIT	Dec. '89	0.93	0.91	0.88	0.86	Ample growth
Weingarten Rlty.	Dec. '89	0.74	0.76	0.83	0.87	Ample growth
Western Inv. RE	Dec. '89	0.92	0.93	0.92	0.90	Ample growth
	TOTAL	0.95	0.98	0.99	0.97	

• Payout of 100% or more of CFS is italicized

Without the special operating items mentioned above for Weingarten and for IRT Property (see footnote), the 1989 cash flow gain averages out at 2.6%. This is below the 5%-6% gains we foresaw in our equity trust review in April 1989, but still solidly in plus territory. We are estimating about a 4.0% gain for 1990, again hopefully trying to be on the low-side.

Dividend Growth and Coverage. Dividends are driven mainly by operating cash flow growth, although there are some important exceptions. Table II, which tallies the dividends paid in each year by these 15 REITs, shows that total payout rose by 2.8% in 1989, which is well below the 5.8% gain of 1988. Some REIT managers say that they underestimated the competitiveness of 1989 property markets and may have moved up payout in expectations of improvements that materialized more slowly than expected. Not surprisingly, Federal Realty boosted payout the most, up 12.2%, while MGI Properties posted the biggest decline in payments actually made, off 15.0%. (Note that MGI's annualized payout rate fell much further, by 30% to a $1.12 annual rate.)

Looking ahead at 1990, we foresee another year of slow growth, up 2.4% on average. We expect the biggest gainers to be New Plan Realty, up 8.3%; Federal Realty, up 6.9%; Weingarten Realty, up 6.8% reflecting a late-1989 payout boost; and Washington REIT, up 5.9%.

The stock market is telling us that these payout growth rates are not competitive with alternative investments, regardless of how remarkable they may be in the face of a deep real estate recession. That's the key to understanding why shares of Federal, United Dominion Realty, and Washington, to cite just a few names, have dotted the new-low list in recent weeks (RSR, Feb. 23 and page 4).

One way to measure the potential for dividend boosts is to look at the margin by which operating cash flow covers payout. Table III computes coverage ratios for our sample of 15 equity REITs. Keep in mind that principal payments on mortgage and other debt must be made out of operating CFS. We haven't quantified debt loads for this study because debt service is relatively small for most REITs in our sample.

Because some equity REITs prefer to hold dividends level even during times of real estate recession, a few REITs sampled pay more than their operating CFS would justify. This produces dividend payout ratios of 1.0 or higher, and we've italicized these high ratios in Table III.

This dividend coverage points to the fact that **First Union Real Estate** and **HRE Properties** have been supporting payout with capital gains. FUR cashed 72¢/sh. gains in 1989 and a total $1.38/sh. gains over the past three years. HRE Properties likewise reported 89¢/sh. gains in 1989 and $1.15/sh. gains over the past three years. HRE's new chairman, Charles Urstadt, intends selling $20 mil. of properties and use some gains to buy up to 1.0 mil. shares in the market.

MARKET PULSE: REALTY STOCKS TAKE A BREATHER

March appears to be a month of firming for realty stocks. The heavy down trend has eased with new lows still outpacing new highs but at a much lower rate. Realty stocks as a group have bounced back strongly, posting net advances of 15 and 21 in the first two weeks of March.

While a strong recovery is not yet likely, the adverse overreaction in the entire group due to bad press and weaker economic reality appear over. The market again is searching for good income stocks with strong fundamentals.

High/low indicator: New lows continue to outpace new highs. The first two weeks of March produced six new highs, significantly stronger than in previous weeks. Two stocks continue to rise from the preceding month.

The number of realty stocks reaching new highs or lows relative to all publicly traded stocks continue to reflect disfavor with the market however. In a world that rewards those who anticipate change correctly, today's realty stock environment provides rich ground to search for 1990 and 1991 winners.

High interest rates continue to keep many equity REITs and property owners from increasing debt capital, slowing portfolio growth. The market may be equating this with cash flow growth, although this logic is overly simplistic and not neccessarily true. Lower origination volume has hurt lenders also. The balance of new lows is comprised of companies experiencing fundamental finance and operational ills.

Week	New Highs	New Lows	Net Highs	-% of All Stock- Highs	Lows
Mar. 9	3	13	-10	0.9%	3.6%
Mar. 2	3	14	-11	1.2	2.5
Feb.23	1	20	-19	0.7	3.5
Feb.16	2	40	-38	0.9	7.3
Feb. 9	2	22	-20	0.8	4.3
Feb. 2	0	30	-30	0.0	3.0
Jan.26	1	33	-32	0.5	3.2
Jan.19	0	20	-20	0.0	3.2
Jan.12	2	15	-13	0.5	3.9
Jan. 5	3	7	-4	0.6	4.6

Six realty stocks hit new highs in February: Thinly traded and closely held **Del Val Financial**'s shares reached new highs after raising its monthly dividend by 3%.

The stock of **General Homes**, the financially troubled Texas homebuilder attempted to avoid possible bankruptcy by swapping $140 mil. of subordinated debt for new convertible preferred.The stock was buoyed when shareholders voted in favor of the conversion, however on March 5, the company fell short of its 85% tender goal and the stock languishes at 3/8ths.

Hollywood Park Realty continues to climb with the possibility the company may go private under the lead of major shareholder Marvin Davis. Other large shareholder groups have been building holdings in the race track owner/operator.

International Income Properties announced on Feb. 15 that it received an offer to acquire its assets in a cash transaction (RSR, Feb. 23) sending its stock soaring 4-1/2 points to close the week at $17. In March IIP shares broke this level and traded as high as 17-5/8 as the market sensed that a deal might be completed.

Shares of **Interstate General L.P.**, builder of St. Charles, master planned Waldorf, Md. community, rose on improved earnings and growth prospects from diversification into Puerto Rico, and acquisition of a homebuilder.

Groups containing new lows, placed by order of magnitude, held their position in March. By loosely based groups and number of new lows in each group:

Equity REITs/property owners - 14: BRE Properties, Burnham Pacific Properties, Chicago Dock & Canal, EQK Realty Investors, Federal Realty, HRE Properties, Income Opportunity Trust, Koger Properties, MGI Properties, Perini Investment Properties, Property Trust of America, Storage Equities, USP REIT, United Dominion Realty Trust.

Chicago Dock was mentioned in a FORBES article about the continued overbuilding of the Chicago office market. **Property Trust** lost steam after Sizeler Property Investors, Inc. dropped its buyout attempt, last offering $11.50 per share. **Storage Equities** cut its dividend 54% to an estimated $0.65 per share for 1990, citing the need to make property improvements to keep properties competitive. We misstated the new payout rate Feb. 23.

We believe now is the right time to buy many of these REITs which still have sound financial and market fundamentals and may be near the bottom of a down price trend. We feel many of these trusts will continue to offer total returns in excess of 10% - 12% making the present a ripe buying opportunity. See Audit's Portfolio Planner in the next issue for our selections.

Syndicators - 4: Equitec Financial, Sierra Real Estate '83, VMS Mortgage Investment L.P., VMS Mortgage Investments II. Finances and the market have soured on these entities and near-term prospects are poor.

Mortgage lenders - 3: Angeles Finance Trust, Mellon Participating Mortgage Trust, Mortgage Investments Plus. MIP is wrestling with two problem loans and we are moving it to the Avoid/Sell Group till they are resolved.

Developers - 2: Forest City B, Mission West Properties. These companies are finding it increasingly expensive to finance land inventories and development.

Homebuilders - 1: NVR L.P., a multimarket homebuilder, has begun to feel pressure from softer markets.

Advance/decline indicator: So far in March, all realty stock price advances have overtaken declines. We believe that this is a strong signal that the bad press real estate has received lately may have run its course and investors are returning to sound issues with a positive cash flow outlook (many also at very attractive current prices).

Into the first half of March, realty stock participation in the positive market move was stronger than since the begining of the year. Our tally shows the group's continued move between positive and negative turned decidedly positive in March.

Week	Adv.	Decl.	Net Adv.	-% of All Stock- Adv.	Decl.
Mar. 9	78	57	+21	2.4%	2.6%
Mar. 2	69	54	+15	2.1	2.5
Feb.23	55	81	-26	3.4	2.2
Feb.16	53	87	-34	2.0	3.1
Feb. 9	64	66	-2	2.0	2.9
Feb. 2	68	71	-3	2.6	2.4
Jan.26	24	117	-93	4.8	5.1
Jan.19	69	69	0	6.7	4.2
Jan.12	44	89	-45	5.5	4.5
Jan. 5	94	42	+52	5.5	4.1
Dec.29	74	60	+14	4.3	6.6
Dec.22	43	102	-59	4.0	6.1